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Japan's Current Account Drops Sharply In 1990

What if the Treasury Department had a bond auction and nobody -- or at least the much sought-after Japanese investors -- didn't come? While much of Wall Street and official Washington pondered that question in 1990, Japan's current account statistics were providing a partial answer. Last year Japan's current account surplus declined 37.4 percent from 1989's total (see Table 1). As a result of the double-entry nature of balance of payments bookkeeping, the current account also is the broadest measure of net capital flows. That suggests that Japan's net overseas investment declined a corresponding amount in 1990.

To the extent that Japanese firms sell more abroad than they buy, the difference is equivalent to the sum of net short- and long-term public and private investment in overseas markets. Table 2 offers the options available for a long-term private investor. The decline in long-term investment exceeded the drop in the current account surplus in 1990. For example, purchases of foreign bonds -- the focus of the Treasury auctions -- dropped to $29 billion, less than a third their 1989 level. Since bond prices were fairly stable last year in the United States, the impact of the Japanese pullback apparently was moderate at best. In short, the hypothetical question about the Treasury auctions has an answer already: Japanese investors are not necessary to sustain the market.

The portion of Table 2 detailing capital inflows shows the effects of the Tokyo stock market turmoil throughout 1990. As prices plummeted foreign investors headed for the exits, withdrawing a whopping $13.3 billion from the

Table 1: Japan's Balance of Payments

(in millions of dollars, IMF value basis)

	1986	1987	1988	1989	1990*
Current Account	$85,845	$87,015	$79,631	$57,157	$35,792
Trade Balance	92,827	96,386	95,012	76,917	63,856
Exports (f.o.b.)	205,591	224,605	259,765	269,570	280,177
Imports (f.o.b.)	112,764	128,219	164,753	192,653	216,321
Services	-4,932	-5,702	-11,263	-15,526	-22,587
Transfers	-2,050	-3,669	-4,118	-4,234	-5,477
Long-Term Capital	-131,461	-136,532	-130,930	-89,246	-43,455
Basic Balance	-45,616	-49,517	-51,299	-32,089	-7,663
Short-Term Capital	-1,609	23,865	19,521	20,811	21,367
Errors and Omissions	2,458	-3,893	2,796	-22,008	-20,938
Overall Balance	-44,767	-29,545	-28,982	-33,286	-7,234

*Preliminary.

Source: Bank of Japan

Table 2: Net Long-Term Capital Flows

(in millions of dollars)

	1989			1990*		
	Outflows	Inflows	Net	Outflows	Inflows	Net
Direct Investment	$-44,130	$-1,054	$-45,184	$-47,941	$1,750	$-46,191
Trade Credits	-4,002	-9	-4,011	744	-2	742
Loans	-22,495	17,813	-4,682	-22,190	39,112	16,922
Securities	-113,178	85,144	-28,034	-39,681	34,653	-5,028
Stocks	-17,887	6,998	-10,889	-6,256	-13,276	-19,532
Bonds	-94,083	2,400	-91,683	-28,961	16,991	-11,970
Yen-Denominated Bonds Issued in Japan	-1,208	n.a.	-1,208	-4,464	n.a.	-4,464
External Bonds**	n.a.	75,746	75,746	n.a.	30,938	30,938
Other	-8,313	978	-7,335	-11,572	1,672	-9,900
Total	-192,118	102,872	-89,246	-120,640	77,185	-43,455

Note: A negative sign indicates a capital outflow.

*Preliminary.
**Bonds issued outside of Japan by Japanese institutions.

Source: Bank of Japan

market. The decline in securities prices corresponded to a rise in the yields on bonds, which overseas buyers snapped up. Finally, sales of external bonds, which often are equity-linked instruments sold by Japanese companies in Europe, dropped dramatically as the attractiveness of the equity component evaporated in the minds of foreign investors.

On balance, inbound and outbound long-term capital flows both declined from 1989 levels and, although the inbound flow dropped less -- by $25.7 billion -- it somewhat cushioned the blow of the lower outflow. These numbers hint at a reason why U.S. financial markets hardly noticed the relative inactivity of Japanese investors. Funds are largely interchangeable; the pullout of foreign participants from Japan's stock market was a factor in enabling American and European investors to replace Japanese participants that were restricting their foreign activity.

Also meeting the apparent worldwide need for capital was another substitute for securities purchases, Japanese direct investment. These flows -- which suggest much more active involvement and long-term commitment than investments in stocks and bonds -- continued to increase in 1990. At $47.9 billion direct investment exceeded the balance of securities purchases for the first time since Japanese overseas investment became substantial in the early 1980s.

As noted above, although the decline in outbound securities purchases was offset partially by a decline in inbound flows and an increase in direct investment abroad, Japan's net capital outflow -- as measured by the current account surplus -- still declined. The shrinkage was virtually across the board, led by a reduction in the trade surplus. The services deficit widened, indicating still-surging tourism. The transfers account showed a larger net outbound flow partly as a result of payment of the first installments on the $4 billion Tokyo had pledged as of the end of 1990 to the Persian Gulf multilateral forces and Middle East nations adversely affected by the economic sanctions against Iraq and the gulf conflict. If Tokyo is able to fulfill its early 1991 pledge of an additional $9 billion, the current account surplus will get a significant downward nudge this year.

The probable slowdown in economic growth this year in both Japan and its leading market, the United States, will reduce both Japanese imports and exports compared to the levels they otherwise would reach. On balance, most experts expect relatively little change in the current account in 1991. If that proves true, Japan's external imbalance, which declined from 4.2 percent of gross national product in 1986 to an estimated 1.2 percent in 1990, could diminish further. A roughly constant surplus also would imply little change in Japan's net flow of funds to world capital markets. One way or another, Treasury will get its share; it need not worry about holding an auction to which nobody comes.

Douglas Ostrom

Kaifu Concedes To Opposition Demands On Gulf Aid Funding

Following weeks of often-heated debate with the political opposition and behind-the-scenes dealmaking, Prime Minister Toshiki Kaifu appears finally to

NOTE

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Entire Issue